

# *Fordham Environmental Law Review*

---

*Volume 7, Number 3*

2011

*Article 5*

---

## Voluntary Environmental Compliance Auditing: A Primer

Somendu B. Majumdar\*

\*

Copyright ©2011 by the authors. *Fordham Environmental Law Review* is produced by The Berkeley Electronic Press (bepress). <http://ir.lawnet.fordham.edu/elr>

# VOLUNTARY ENVIRONMENTAL COMPLIANCE AUDITING: A PRIMER

*Somendu B. Majumdar\**

## INTRODUCTION

The Clean Air Act Amendments of 1990 ("CAAA") were signed into law by President Bush on November 15, 1990.<sup>1</sup> Prior to the enactment of CAAA, no federal environmental statute contained such broad compliance provisions along with specific enforcement criteria. The "compliance certification" requirement of this latest federal environmental statute has become the *raison d'être* for industries and the business community at large to pay heed.<sup>2</sup> "Compliance" and "compliance audit" have become the latest buzzwords in the environmental community.

The word "audit" in this context conveys a more subtle, yet extensive, meaning than its ordinary plain English version. An environmental compliance audit ("compliance audit") is much more than a routine examination of accounts or claims. In its Environmental Auditing Policy Statement of July 9, 1986, the Environmental Protection Agency ("EPA") defined a compliance audit as "[a] systematic, documented, periodic and objective review by regulated entities of facility operations and practices related to meeting environmental requirements."<sup>3</sup>

---

\* J.D., 1988, Fordham University; Ph.D., Chemical & Environmental Engineering, 1972, University of Maine. The author is partner-in-charge of the Environmental, Health and Safety Practice Group of Pepe & Hazard, a business law firm in Connecticut.

1. Clean Air Act Amendments of 1990, Pub. L. No. 101-549, 104 Stat. 2399, 2684-85 (1990) (codified as amended in scattered sections of 42 U.S.C. §§ 7401-7671q (1994)).

2. 42 U.S.C. § 7414(a)(3).

3. Environmental Auditing Policy Statement, 51 Fed. Reg. 25,004, 25,006 (1986) [hereinafter Final Auditing Statement].

When performing a compliance audit, a business must check federal, state, and local statutes, regulations, codes, and ordinances to ensure full compliance with each. A compliance audit thus requires a full-fledged inquiry into, and scrutiny of, the total environmental standing of a business or commercial entity with respect to applicable laws and regulations, no matter how imprecise or ill-defined they may be.<sup>4</sup>

Against this backdrop, it is important that a compliance audit not be relegated to assignment as a routine responsibility of lower level in-house technical personnel and mid-level managers. The new statutory and regulatory provisions require a commitment from the highest levels of management of a corporation to comply with all statutory and regulatory requirements to protect the environment and public health.<sup>5</sup> Any lapse in this commitment can be extremely costly, both at professional and personal levels. The sanctions for non-compliance can include both civil penalties and imprisonment, and they may very well apply to the top level of a corporation's management.

The regulatory agencies, including the Department of Justice ("DOJ"), have proclaimed that federally enforceable regulations need "sharp teeth" to prevent violations and to keep the regulated community honest and law-abiding.<sup>6</sup> The regulatory agencies tout the benefits of undertaking a compliance audit as a practical tool to establish and maintain a corporate compliance record.<sup>7</sup> They also

4. See generally Thomas E. Lindley & Jerry B. Hodson, *Environmental Audit Privilege: Oregon's Experiment*, 24 Env't Rep. (BNA) No. 26, at 1221 (Oct. 29, 1993).

5. John L. Payne, *Environmental Auditing: Beyond Due Diligence*, C945 ALI-ABA 317, 324-31 (Oct. 6, 1994).

6. See generally Joe D. Whitley & Trent B. Speckhals, *Increased Prosecution is Predicted*, NAT'L L.J., Dec. 5, 1994, at C1, C4.

7. Both EPA and DOJ have suggested that the findings of voluntary environmental compliance audits will generally not be used against the companies by the government. See EPA, *Environmental Auditing Policy Statement*, 50 Fed. Reg. 46,504 (1985) (initial statement) [hereinafter *Interim Guidance*]; Final Auditing Statement, *supra* note 3, at 25,004; Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875 (1995) [hereinafter *Interim Policy*]; Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations, 60 Fed. Reg. 66,706 (1995) [hereinafter *Final Policy*]. For the DOJ's statement on this issue, see FACTORS IN DECISIONS ON CRIMI-

emphasize that only through a compliance audit's comprehensive probative inquiry into business and operational activities will top executives be able to check the environmental pulse of their corporations.<sup>8</sup>

The compliance audit is strictly voluntary.<sup>9</sup> Unlike other formal audits, there is no statutory or regulatory requirement for any commercial or business entity to undertake a compliance audit. At this time, a federal or state agency may only include provisions of a compliance audit as part of a settlement agreement with a party which allegedly failed to comply with applicable environmental laws.<sup>10</sup>

There are subtle differences between a compliance audit and a commercial audit. A commercial audit is often the work of one professional group; a compliance audit is an all-encompassing examination of multiple aspects of a business operation by professionals of several disciplines.<sup>11</sup> These professionals, such as environmental scientists, engineers, geologists, and lawyers, bring not only their knowledge of environmental issues, but also their trained eyes and ears to spot potential environmental problems and potential

---

NAL PROSECUTIONS FOR ENVIRONMENTAL VIOLATIONS IN THE CONTEXT OF SIGNIFICANT VOLUNTARY COMPLIANCE OR DISCLOSURE EFFORTS BY THE VIOLATOR (July 1, 1991) [hereinafter *DOJ Memorandum*], quoted in Restatement of Policies Relating to Environmental Auditing, 59 Fed. Reg. 38,455, 38,458 (1994).

8. The EPA's interim policy offers a reduction in civil penalties if the company that discovers a violation during its audit satisfies seven criteria specified in the interim policy. See *Interim Policy*, *supra* note 7; see also Lisa G. Dowden, *The Case in Favor of an Environmental Audit Privilege*, 29 Chem. Waste Lit. Rep. 174 (Jan. 1995). The Department of Justice is not a party to EPA's interim policy. However, it has announced, through its environmental enforcement policy, that all voluntary compliance efforts including environmental audits will be favorably considered in its prosecutorial discretion. See Restatement of Policies Relating to Environmental Auditing, 59 Fed. Reg. 38,455, 38,458 (1994) (quoting *DOJ memorandum*).

9. See Michael Herz, *Environmental Auditing and Environmental Management: The Implicit and Explicit Federal Regulatory Mandate*, 12 CARDOZO L. REV. 1241 (1991).

10. Typically, an environmental compliance audit is required of a company by an administrative order, consent order, or decree. Hence, this is often negotiated in a settlement posture between a company and an agency. *Id.* at 1252.

11. For a discussion of multiple-discipline requirements for conducting a successful audit, see Payne, *supra* note 5, at 324-25.

liability resulting from failure to address such problems promptly and properly.<sup>12</sup>

Due to the breadth and depth of such an inquiry, a compliance audit sets itself apart from the typical Phase I or Phase II environmental investigation of a property that is often undertaken by the seller or the prospective buyer of a piece of real property.<sup>13</sup> While a compliance audit can be undertaken in contemplation of an acquisition or merger, often as a supplement to a transactional audit based on a Phase I or Phase II environmental investigation, it is generally undertaken as an ongoing review of the compliance records of a business entity. Its basic purpose is to reveal any actual or potential environmental violation and to alert the corporate management so that necessary remedies can be undertaken.

This Article delineates various legal issues that may confront a corporation when determining whether it should undertake a voluntary environmental compliance audit. Part I discusses the contents of a compliance audit. Part II provides a legal perspective on the burdens and benefits of compliance audit preparations. Part III describes the position of the various cognizant government authorities and examines the dilemma that industry finds itself in as a result of the current regulatory position of government. Part IV outlines the legal privilege and confidentiality afforded to industry. Part V details the legal obligation of disclosure under a variety of regulations. Part VI examines the conflicting obligations that face industry when conducting voluntary audits. Part VII discusses the risks associated with conducting voluntary audits. Part VIII pro-

---

12. See generally STEPHEN HOFFMAN, *PLANNING, STAFFING, AND CONTRACTING AN ENVIRONMENTAL AUDIT*, ENVIRONMENTAL AUDIT HANDBOOK SERIES (1989).

13. In the context of a purchase or sale of a piece of real property, a transactional environmental audit is often performed. Although there is no fixed format or scope for undertaking such site investigations, they are often categorized as a Phase I or Phase II environmental audit. Typically, a Phase I audit will be limited to general site survey, agency file review, historical ownership and usage of the property, and interviews with property owners and users. Phase II goes beyond Phase I by including sample collection and analysis, a detailed land-use evaluation, and a more comprehensive site survey, including the location of the property vis-a-vis other important industrial and commercial properties in the neighborhood. See Payne, *supra* note 5, at 15-31 for a detailed account of Phase I, II, and III audits.

vides possible solutions to the compliance auditing quandary and concludes that, for now, a prudent corporation should avail itself of common law evidentiary privileges when undertaking a voluntary compliance audit.

### I. CONTENTS OF A COMPLIANCE AUDIT

There are no laws which require the performance of a compliance audit. Nor are there any legally established patterns for conducting such audits. The content and format of a compliance audit have been left to the imagination of the auditors. The role of a compliance audit in the total environmental quality management ("TEQM") of a business implies that it should be conducted according to appropriate legal standards and requirements.<sup>14</sup>

Common sense would seem to dictate that every business entity should design its compliance audit to reflect its business, operational activities, and organizational structure. At the very minimum, a typical compliance audit should include a thorough compliance profile of a facility in order to appreciate fully the effectiveness of its overall environmental program and to reveal any actual or potential areas of non-compliance.<sup>15</sup>

In the pro-enforcement 1990s, a comprehensive compliance audit is *de rigueur* for ensuring statutory and regulatory compliance. A compliance audit should be undertaken by a corporation to develop a current compliance profile of a business entity to enable management to understand the so-called environmental health of the business operation and to plan accordingly to avoid future pitfalls and associated environmental liability.<sup>16</sup> Hence, a compliance audit

---

14. James R. Moore et al., *Why Risk Criminal Charges by Performing Environmental Audits?*, [July-Dec.] *Toxics L. Rep. (BNA)* No. 16, 503, 504 (Sept. 18, 1991).

15. The goal of a compliance audit is to determine the status of the company's environmental compliance. It is generally used as a practical tool to establish the effectiveness of current environmental efforts. An environmental site assessment, on the other hand, is undertaken by a company that is a party to a commercial real estate transaction to determine the existing environmental conditions of real property that is on the selling block. *See generally* ENVIRONMENTAL AUDITS (Government Institutes, Lawrence B. Cahill & Raymond W. Kane eds., 1989).

16. *See, e.g.,* *People v. Matthews*, 7 Cal. App. 4th 1052 (Ct. App. 1992)

should be geared toward revealing all essential environmental and regulatory aspects of business activities, including, but not limited to, permit and registration programs, handling and storage of raw materials and finished products, record keeping, clean-up and notification procedures for accidental releases, off-site transportation and disposal of waste materials, and a company-wide appreciation of TEQM.<sup>17</sup>

The heart of a compliance audit, arguably, is the gathering and analysis of pertinent data, information and records, along with their complete dissection by using the statutory and regulatory scalpel to reveal the true environmental health of the corporation. This data gathering, however, should not be limited to corporate records and files. It must include review and inspection of appropriate agency files, along with a legal inquiry as to what federal, state and local laws, and attendant regulations may apply in a particular situation, and whether or not the corporation is in compliance with them.<sup>18</sup>

---

(holding officer of a corporation liable for environmental violations even though it may have been objectively impossible for him to control all activities of the corporation). It is often said that ignorance of the law is no defense. Innocence, however, may indeed be a good defense. Both EPA and DOJ officials have repeatedly stressed their uncompromising intolerance for environmental crimes and noncompliance in general. Since corporate management may not always be fully involved and, thus, aware of all environmental noncompliance, it may, in reality, remain completely ignorant of major environmental violations by the corporation. A comprehensive compliance audit can uncover such violations, thereby allowing the management to promptly correct the problems. This, in turn, can effectively reduce, if not completely eliminate, any resulting penalties.

17. The term "total environmental quality management" is suspected to be derived from the common business term of "total quality management," which was introduced during the 1970's by the management pundits as a worthy corporate goal. In reality, it means full environmental compliance through pro-active plans and effective management of all environmental matters ranging from permitting to reporting and clean-up. *See generally* E. Donald Elliott, *Environmental TQM: Anatomy of Pollution Control Program that Works!*, 92 MICH. L. REV. 1840 (1994) (reviewing QUALITY ENVIRONMENTAL MANAGEMENT SUBCOMMITTEE, PRESIDENT'S COMMISSION ON ENVIRONMENTAL QUALITY, TOTAL QUALITY MANAGEMENT: A FRAMEWORK FOR POLLUTION PREVENTION (1993)).

18. In this respect, an environmental compliance audit resembles a typical environmental audit, Phase I or Phase II, or both.

## II. A LEGAL PERSPECTIVE

There is a valid concern that any voluntary undertaking of this type will needlessly expose a corporation to legal liabilities and sanctions.<sup>19</sup> There is also a question of current or future vulnerability should a corporation lack knowledge of its actual compliance status.<sup>20</sup> Ignorance of law can hardly be used as a defense for non-compliance.

Both of these well-articulated positions have real merits, and there is no easy answer to the question of whether it is better to be knowledgeable or ignorant of non-compliance. There is, of course, the consolation that one cannot violate any law or regulation for failure to undertake a compliance audit. In the United States, unlike many Western European countries,<sup>21</sup> a compliance audit is not mandatory.<sup>22</sup> Also, the majority of what is required by a compli-

---

19. There are both statutory and regulatory sanctions for environmental violations. Depending on the nature of the violation or non-compliance, the penalties may include fines and criminal sanctions. *See* 42 U.S.C. § 9609 (1994) (an example of civil fines under CERCLA); 42 U.S.C. § 6928(d) (1994) (an example of criminal penalties for RCRA violation). The responsible corporate officer doctrine allows the government to convict an officer even though such officer lacks direct knowledge or intent. This doctrine rests on negligence theory and can therefore be invoked based on the findings of past violations. The doctrine was articulated by the Supreme Court in *United States v. Park*, 421 U.S. 658 (1975). This case is often credited as the inspiration of statutory and regulatory provisions requiring that permit applications and reports be certified by a responsible corporate officer.

20. *See* Edmund B. Frost, *Voluntary Environmental Compliance Audits: A DOJ Policy Failure*, [July-Dec.] *Toxics L. Rep.* (BNA) No. 16, 499 (Sept. 18, 1991); Moore, *supra* note 14, at 504-05.

21. In most Western European countries, environmental compliance auditing is commonplace. It is generally undertaken whenever there is a property transfer. This also forms the basis for which permits must be obtained by an entity. A proposed Directive of the European Union would require environmental audits to be performed at many industrial facilities. *See generally* Alistair Clark, *Environmental Due Diligence in the European Community*, presented at the SECOND ANNUAL CONFERENCE ON PRACTICAL IMPLICATIONS OF ENVIRONMENTAL LAW IN THE EUROPEAN COMMUNITY, The American Bar Association, Stamford, Connecticut (Apr. 18, 1991).

22. As of now, no environmental statute or regulation, either at the federal or state level, requires the performance of an environmental compliance audit. It can, however, be imposed as a specific condition of an administrative consent



ance audit can be performed by the corporation's own employees, without resorting to outside experts, except where specifically needed. Furthermore, a compliance audit follows no rigid format or procedure.

An audit, however, should not be undertaken casually or merely as a chore. To be meaningful, a compliance audit must include an in-depth examination of past and present environmental plans, procedures and programs, past and current administrative orders, consent decrees and the like, and their ultimate resolutions.<sup>23</sup> By necessity, a compliance audit should go beyond the cursory review of in-house files and records. To be complete, it must include a thorough review of appropriate agency files, permit documents and interviews with knowledgeable individuals, particularly those who are involved in day-to-day operations.<sup>24</sup>

A compliance audit may be conducted by using a check-list or by using long forms. It may be done annually as part of a business plan or on an on-going basis as part of a regular program. Compliance audits should be conducted as part of a corporation's regular environmental monitoring and not only for sale purposes. A compliance audit should be part and parcel of the environmental monitoring program of a business entity.<sup>25</sup>

The main impetus of a compliance audit is to establish the past compliance history and to develop a well-meaning compliance program for a corporation, irrespective of its size, type or location.<sup>26</sup> The goal is to establish a comprehensive environmental pro-

---

order or consent decree when a company is notified of an alleged environmental violation by a regulatory agency. *See* *United States v. United Technologies Corp.*, No. H-90-715 (D. Conn. Jan. 20, 1993).

23. The purpose of undertaking a compliance audit is to determine current compliance efforts and whether there are any environmental violations. The goal is to identify and, subsequently, rectify or remedy such violations. Hence, a compliance audit goes beyond information gathering, which is the goal of an environmental audit.

24. A compliance audit, by its very nature, should be sufficiently comprehensive so that its purpose is justified and its goals are attained.

25. This is indeed the current recommendation of both EPA and DOJ, as well as various environmental advocacy groups. *See* *People v. Matthews*, 7 Cal. App. 4th 1052 (Ct. App. 1992).

26. Since environmental issues are almost universal, they have direct and indirect implications on all business entities, irrespective of their physical loca-

file of a facility or business, including its past or present non-compliance or potential environmental problems.<sup>27</sup>

Much of the apparent benefit of a compliance audit relates to the certification requirements of the latest federal and state regulations that are bootstrapped to various permitting programs.<sup>28</sup> This certification has lately become a general requirement in connection with a permit application submitted to a federal or state agency.<sup>29</sup> Needless to say, it will be unlawful for a senior executive of a corporation to certify without personally ensuring the truth of the statement.<sup>30</sup>

---

tion. Moreover, the nature, and not the size, of a business operation generally dictates the breadth and depth of an environmental compliance audit.

27. Strictly speaking, there is no standard goal for an environmental compliance audit. However, the focus of such an audit is always on environmental compliance issues, whether past, present or future. A comprehensive environmental compliance audit should look into each of these three stages in order to make the audit meaningful and complete.

28. The following is a sample of such certification proviso which must be signed by a responsible corporate official:

I certify under penalty of law that this document and all attachments were prepared under my direction or supervision in accordance with a system designed to assure that qualified personnel properly gather and evaluate the information submitted. Based on my inquiry of the person or persons who manage the system, or those persons directly responsible for gathering the information, the information submitted is, to the best of my knowledge and belief, true, accurate and complete. I am aware that there are significant penalties for submitting false information, including the possibility of fine and imprisonment for knowing violations.

The certification has become a required and distinct element of both federal and state environmental permits. *See* 40 C.F.R. § 270.11 (1995).

The genesis of this certification requirement can be traced to the "responsible corporate officer" doctrine. *See* 40 C.F.R. § 270.11(d) (1990) for the mandatory requirement of certification by a responsible corporate officer for permit application and reports under the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6993(k) (1994) ("RCRA"). A similar requirement has been incorporated into the permitting programs under most major federal and state environmental laws. *See, e.g.,* Clean Air Act Amendments of 1990, 42 U.S.C. § 7414(a)(1) (1994) ("CAAA").

29. Any failure to certify or modify the certification language may be a cause for denial of a permit, license or any other form of approval by the issuing agency. *See generally* 40 C.F.R. Part 270 (1995).

30. This clearly arises from the text of the certification. Such certification,

On the other hand, complete disclosure of a compliance audit may bring untold miseries if the audit discovers blatant violations and shortcuts. In such a case, most evidence of systematic disregard and willful violations of applicable environmental laws and regulations is fully discoverable. By taking initiatives to redress past violations in the best way possible, however, management can possibly win the sympathy of the regulatory agencies.<sup>31</sup> This, in turn, may lower the penalties that may otherwise be imposed by the enforcement agencies,<sup>32</sup> as the guidelines developed by the U.S. Sentencing Commission clearly acknowledge such good deeds.<sup>33</sup> Unfortunately, there is no current statutory or regulatory protection for a prior non-compliance discovery by a corporation. Therefore, by undertaking a voluntary audit, a corporation may subject itself to involuntary sanctions. The extent of any sanction, however, is a discretionary matter of the enforcement agencies.<sup>34</sup>

---

without establishing the accuracy and truthfulness of the information provided, can lead to serious sanctions. *See United States v. Johnson & Towers, Inc.*, 741 F.2d 662, 666-67 (3d Cir. 1984), *cert. denied* *Angel v. United States*, 469 U.S. 1208 (1985).

31. On November 16, 1993, the advisory working group to the U.S. Sentencing Commission on environmental sanctions issued its second draft to provide sentencing guidelines for environmental crimes. *See New Draft on Sentencing Corporations for Environmental Crimes Released for Review*, 24 Env't Rep. (BNA) No. 29, at 1331 (Nov. 19, 1993). The draft guidelines developed by the Sentencing Commission must, however, be submitted to the Congress for approval before such guidelines can be used by the federal courts. *Id.*

32. *Id.*

33. *Id.*

34. Pursuant to its current policy on voluntary environmental audits, EPA may exercise a wide range of discretion, including whether the matter should be referred to DOJ for criminal prosecution. Criminal enforcement by DOJ has thus far been conducted independently from EPA's administrative and civil enforcement programs. Both EPA and DOJ have announced their intentions to exercise their discretion if the findings involving past violations are disclosed voluntarily. *See Letter from Richard B. Stewart, Assistant Attorney General, Department of Justice to Admiral James D. Watkins, Secretary of Energy, and William K. Reilly, Administrator of EPA* (Sept. 14, 1989) (on file with the author).

### III. THE GOVERNMENT'S POSITION

The EPA has long recognized a compliance audit program as a meaningful tool to develop and ensure a workable environmental management scheme,<sup>35</sup> and has been a staunch advocate for voluntary compliance auditing by corporate members of the regulated community.<sup>36</sup> After all, an audit accomplishes valuable goals of the agency. It obtains compliance information and causes effective remedial measures to take place once non-compliance is found. The corporation itself becomes aware of its compliance status, and the agency obtains the same information by means of legal disclosure without costly and time-consuming site inspections and record searches. The agency is free to use such information in any way, including requiring the corporation to rectify all non-compliance problems. In addition, the penalties based on the findings of a compliance audit can be a quick source of revenue generation by an agency without going through any fierce budgetary process or congressional approval.<sup>37</sup>

Not surprisingly, in the 1980s, EPA lost no time launching a high-exposure selling campaign for the voluntary compliance audit program as part of its environmental enforcement policy. Armed with the timely passing of several new-breed federal environmental statutes in the 1980s, such as the Hazardous and Solid Waste Amendments of 1984 ("HSWA"),<sup>38</sup> and the Comprehensive Environmental Response, Compensation, and Liability Act

---

35. See Memorandum from Thomas L. Adams, Jr., Assistant Administrator for Enforcement and Compliance Monitoring of EPA to various addressees regarding Final EPA Policy on the Inclusion of Environmental Auditing Provisions in Enforcement Settlements (Nov. 14, 1986) (on file with the author).

36. See Environmental Protection Agency, Reinstatement of Policies Related to Environmental Auditing, 59 Fed. Reg. 38,456 (July 28, 1994) (reaffirming EPA's Final Auditing Statement of 1986).

37. EPA has broad discretion under specific statutory provisions for administrative and civil penalties. Monies collected in the form of civil penalties go into the general pool of the Treasury. See *Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found., Inc.*, 484 U.S. 49, 53 (1987).

38. Hazardous and Solid Waste Amendments of 1984, Pub. L. No. 98-616 § 232(a), 98 Stat. 3,221, 3,257 (1984) (codified at 42 U.S.C. § 6928(d)(1994)) (amending the Resource Conservation and Recovery Act of 1976, 42 U.S.C. §§ 6901-6991 (1994)).

("CERCLA"),<sup>39</sup> as amended by the Superfund Amendments and Reauthorization Act ("SARA"),<sup>40</sup> and especially Title III of SARA, otherwise known as the Emergency Planning and Community Right-to-Know Act ("EPCRA"),<sup>41</sup> EPA introduced its voluntary compliance audit proposal. On July 9, 1986, EPA officially released its draft proposal<sup>42</sup> to encourage the regulated community to undertake compliance audits and to indicate the scope of such voluntary programs.<sup>43</sup>

In later years, EPA attempted to put some teeth into this voluntary program by making the compliance audit a part of its overall enforcement policy and settlement program.<sup>44</sup> The implicit message conveyed was simple: EPA would favor a lenient settlement of any past or present non-compliance discovered through a compliance audit and promptly disclosed to the agency.<sup>45</sup> In a 1991 memo to the United States Attorneys,<sup>46</sup> Richard Stewart, Assistant Attorney General of DOJ, suggested that the following factors should be taken into account by the federal prosecutors to determine whether to prosecute a company when it voluntarily discloses the findings of a compliance audit:

- (a) whether and how the voluntary disclosure by the company can substantially aid in the investigation process;
- (b) the degree and timeliness of the company's cooperation with the agency's investigation;
- (c) the scope of the company's environmental compliance program, including its compliance and/or management audits; and
- (d) the result of review of additional factors, for example, past

39. 42 U.S.C. §§ 9601-9675 (1994).

40. Pub. L. No. 99-499, 100 Stat. 1613 (1986)(codified in 42 U.S.C. § 9621-9675 (1994)).

41. 42 U.S.C. §§ 11001-11050 (1988 & Supp. V 1993).

42. Final Auditing Statement, *supra* note 3, at 25,004.

43. *Id.*

44. EPA's environmental auditing policy statement of July 9, 1986 has been interpreted and expanded by EPA officials through public comments and presentations. Together, they represent EPA's overall policy concerning voluntary compliance audits.

45. See generally Frost, *supra* note 20, at 499-502.

46. See Joseph G. Block, *Good First Step or Hidden Dagger? The Effect of Voluntary Disclosure on DOJ Prosecutorial Discretion*, ENVTL. NEWS (Venable, Baetjer, Howard & Civiletti) Fall 1991 (on file with the author).

pervasiveness of noncompliance, implementation of internal disciplinary action based on the result of discovery of a violation, and overall compliance efforts after the disclosure of the violation.<sup>47</sup>

The Department of Justice has echoed a view similar to that of EPA.<sup>48</sup> As a result, while DOJ agrees to use prosecutorial discretion, it has not agreed to any evidentiary privilege against a corporation that voluntarily discloses its past non-compliance. In summary, neither EPA nor DOJ has agreed to stipulate that a voluntary disclosure based on the findings of a voluntary act is protected and, hence, no penalty should be assessed against the culpable corporation for coming forward and promptly correcting any deficiency thus discovered.

In its latest interim policy statement, published on April 3, 1995,<sup>49</sup> the EPA declared that in some cases it will not seek criminal prosecution if a company voluntarily reports and corrects any violation to EPA promptly.<sup>50</sup> There is no promise, however, of an across-the-board privilege or immunity.<sup>51</sup> As a result, the basic thrust of EPA's original policy, that is centered around the agency's discretion, still remains in place.

The tacit message from EPA rejecting a protective privilege or immunity has not been lost on the business world. While corporations initially found certain benefits in compliance auditing, such as better control of their operational activities and a detailed work plan for future plant management, they quickly discovered its obvious pitfalls.<sup>52</sup> As of now, there is no single federal environmental statute or federal regulation that forbids prosecution, and thus protects the regulated community from the long arm of regulatory enforcement, when a voluntary audit reveals non-compliance.<sup>53</sup> It is therefore no surprise that offering an olive branch

---

47. *Id.*

48. *See DOJ Memorandum, supra* note 7, at 1.

49. *See* Voluntary Environmental Self-Policing and Self-Disclosure Interim Policy Statement, 60 Fed. Reg. 16,875 (1995).

50. *Id.*

51. *Id.* at 16,878.

52. David Ronald, *The Case Against an Environmental Audit Privilege*, 29 CHEM. WASTE LIT. REP. No. 2, 167 (Jan. 1995).

53. *See* Laurence S. Kirsch & J. Walter Veirs, *Environmental Law*, NAT'L L.J., Mar. 11, 1996, at B5, B6.

by EPA and DOJ in the form of prosecutorial discretion for the eventual settlement of violations has not swayed many corporations.<sup>54</sup> Many of them find this regulatory program and its underlying policy a cynical ploy by the agency to trap the trusting.<sup>55</sup>

Historically distrustful of the regulatory agencies, and now dismayed by this apparent disparity between the agency's expectation and its stated position, the regulated community has largely ignored the compliance audit.<sup>56</sup> The irony being that both regulators and the regulated community have yet to reap the obvious benefits of a well-planned compliance audit.

#### IV. LEGAL PRIVILEGE AND CONFIDENTIALITY

At the heart of the current controversy surrounding compliance audits and the disclosure of audit findings is the question of what legal privilege or confidentiality can attach to these audits. If such audits cannot be legally protected from disclosure to third parties, including regulatory and enforcement agencies, they may result in self-inflicted injury.<sup>57</sup>

At this time, three types of legal privilege offer protection, albeit in varying degrees, from disclosure: (1) the attorney-client privilege; (2) the work-product rule; and (3) the self-evaluation privilege. Under the attorney-client privilege, all communications between the attorney and the client are considered sacrosanct and confidential.<sup>58</sup> They are protected by the venerable rule that jus-

54. See Ronald, *supra* note 52, at 168.

55. See Moore, *supra* note 14, at 504-05. See also Ronald, *supra* note 52, at 171.

56. See generally *Enforcement, Companies Say EPA Enforcement Policy Collides with Voluntary Audit Programs*, Env't Rep. (BNA) No. 117, at A-7 (June 24, 1994); Cheryl Hogue, *Audit Legislation Gains in States, But Some Predict Slowdown in Future, Analysis and Perspective*, 26 Env't Rep. (BNA) No. 18, at 882 (Sept. 1, 1995).

57. There is a debate among legal scholars whether a voluntary performance of an environmental compliance audit will result in involuntary disclosure of past non-compliance. Some argue that absent such audits, most of the companies that are not aware of any past violations will have nothing to disclose. As a result, they argue, any voluntary environmental audit can cause unnecessary risks. See generally Moore, *supra* note 14, at 503-09.

58. See FED. R. EVID. 501.

tice should not inhibit or compromise legal representation to which everybody is entitled. In a recent case, however, *In re Grand Jury Investigation*,<sup>59</sup> the Ninth Circuit Court of Appeals held that the party asserting this privilege must make a *prima facie* showing that the privilege protects the information being withheld.<sup>60</sup> Additionally, this privilege can only be asserted by the client, and not by the attorney.<sup>61</sup>

The work-product rule, on the other hand, protects information or documents that are collected by an attorney in anticipation of litigation or in preparation for a trial.<sup>62</sup> This protection is limited, hinging on a qualified claim of anticipated litigation or trial.<sup>63</sup> Pursuant to Rule 26(b)(3) of the Federal Rules of Civil Procedure, an adversary can ask for disclosure of certain information thus collected, except for those documents incorporating the attorney's mental preparation for litigation or trial.<sup>64</sup> The request will be granted when the adversary can show a "substantial need" for such information which cannot be obtained from other sources without "undue hardship."<sup>65</sup>

The self-evaluation privilege is an emerging legal principle and may be invoked when certain materials, which indicate possible violations, are unexpectedly discovered during internal investigations.<sup>66</sup> In addition, one may invoke the constitutional guarantee

---

59. 974 F.2d 1068 (9th Cir. 1992).

60. *Id.* at 1071.

61. This privilege belongs to the client and, hence, the attorney cannot waive it without the client's permission. *See Radiant Burners, Inc. v. American Gas Ass'n*, 320 F.2d 314 (7th Cir.), *cert. denied*, 375 U.S. 929 (1963).

62. *See Hickman v. Taylor*, 329 U.S. 495, 510-11 (1947). Such immunity, however, does not apply to documents prepared in the regular course of business. *See United States v. Gulf Oil Corp.*, 760 F.2d 292, 296-97 (Temp. Emer. Ct. App. 1985).

63. *See* FED. R. CIV. P. 26(b)(3); *James Julian, Inc. v. Raytheon Co.*, 93 F.R.D. 138, 141 (D. Del. 1982).

64. *See* FED. R. CIV. P. 26(b)(3).

65. *See* 8 CHARLES A. WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 2024 (Civil) (1970); 8 CHARLES A. WRIGHT, ET AL., *FEDERAL PRACTICE AND PROCEDURE* § 2025 (1994).

66. The audit privilege legislation passed in Oregon, Colorado, Indiana and Kentucky creates a self-evaluation privilege for audit reports. This emerging trend is currently being reviewed by the legislators of several other states. *See Dowden*,



against self-incrimination in criminal investigations.<sup>67</sup> The Fifth Amendment of the U.S. Constitution protects individuals, but not corporations, from any government compulsion to disclose self-incriminating information or to testify against themselves.<sup>68</sup>

### A. *The Attorney-Client Privilege*

The attorney-client privilege, which was derived from common law principles, is the broadest in scope and cannot be compromised, even upon a showing of substantial need and undue hardship. It cannot, however, be claimed automatically. The burden for establishing the attorney-client privilege lies with the party seeking to invoke it.<sup>69</sup> Furthermore, it is susceptible to certain pitfalls, including waiver.<sup>70</sup> Nevertheless, the attorney-client privilege provides the strongest legal grounds for protecting privileged information from disclosure. It is important to note that Rule 501 of the Federal Rules of Evidence recognizes the privilege of a witness based on the principles of common law.<sup>71</sup> In its Ethical Consideration 4-1,<sup>72</sup> the American Bar Association

---

*supra* note 8, at 175-76.

67. The protection against self-incrimination as set forth in the Fifth Amendment provides that no person "shall be compelled in any criminal case to be a witness against himself." U.S. CONST. amend. V.

68. The Fifth Amendment privilege may be invoked in any state or federal proceeding, civil or criminal, administrative or judicial, but only by individuals. In short, this privilege is strictly personal. However, if immunity is granted, an individual may testify without fear of prosecution. *See* Gerald W. Heller, *Invoking the 5th in Civil Cases*, NAT'L L.J., Feb. 6, 1995, at B9, B11.

69. *United States v. First State Bank*, 691 F.2d 332, 335 (7th Cir. 1982).

70. *See generally*, Heller, *supra* note 68, at B9. A person may waive the privilege by failing to affirmatively assert it on time, and waivers can occur when incriminating facts are voluntarily revealed. *Id.*

71. Rule 501 of the Federal Rules of Evidence governs the attorney-client privilege. This rule evolved from the decision in *United States v. United Shoe Machinery Corp.*, 89 F. Supp. 357 (D. Mass. 1950). *See generally* David Sive & Daniel Riesel, *Self-Critical Analysis and Other Evidentiary Privileges May Fail to Protect the Confidentiality of Routine Environmental Audits*, NAT'L L. J., Feb. 6, 1995, at B4.

72. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4-1 (1981). The attorney-client privilege enables the lawyer to give sound and informed advice to the client.

("ABA") Code of Professional Responsibility also lends support to such privilege since it encourages clients to seek legal assistance at an early stage.<sup>73</sup>

Recently, in *Westinghouse Electric Corp. v. Republic of the Philippines*,<sup>74</sup> the Third Circuit Court of Appeals held that both the attorney-client privilege and work-product privilege were waived completely in connection with an environmental audit.<sup>75</sup> The facts of the case show that Westinghouse had provided documents, prepared during an internal environmental investigation by its outside counsel, to the Securities and Exchange Commission ("SEC") and DOJ.<sup>76</sup> The court ruled that these documents were no longer privileged, particularly after the defendant had made a specific request for their disclosure.<sup>77</sup>

In general, any evidentiary privilege is conditional and may easily be waived.<sup>78</sup> The privilege may be waived even when the allegedly confidential information is disclosed to a third party that happens to be a regulatory or an enforcement agency.<sup>79</sup> Hence, when a premium is placed on the confidential nature of a document, it should not be disclosed to anyone, including govern-

---

73. *Id.*

74. 951 F.2d 1414 (3d Cir. 1991).

75. *Id.* at 1418.

76. *Id.* at 1418-19.

77. *Id.* at 1424-25, 1429. The Third Circuit affirmed the district court's finding that Westinghouse had waived both the attorney-client and work product privilege through its disclosure of an environmental audit. *Id.* In general, any voluntary disclosure of a protected communication can waive this privilege. See *Upjohn Co. v. United States*, 449 U.S. 383 (1981).

78. It is still debated, and the courts are divided, whether the disclosure of audit results to a regulatory agency waives the attorney-client or work product privilege. See *Chamberlain Mfg. Corp. v. Maremont Corp.*, No. 90 C 7127, 1993 WL 11,885 (N.D. Ill. Jan. 19, 1993); Jill A. Hornstein, *Paying the "Traditional Price" of Disclosure: The Third Circuit Rejects Limited Waiver of the Attorney-Client Privilege: Westinghouse Electric Corp. v. Republic of the Philippines*, 71 WASH. U. L.Q. 467 (1993); see also *In re Leslie Fay Cosmetics Inc. Sec. Litig.*, 152 F.R.D. 42, 45 (S.D.N.Y. 1993).

79. This is not universally accepted. Under the "selective waiver doctrine," information disclosed to a government agency in connection with the government's investigation does not waive the attorney-client privilege or the work product doctrine. See also *Westinghouse*, 951 F.2d at 1424-25.

mental agencies, other than the attorney, as such candor may compromise evidentiary privileges.

The attorney-client privilege is available when the following distinct elements are present:

- (1) verbal and/or written communications between an attorney and his/her client;
- (2) such communications are strictly for obtaining legal advice; and
- (3) the privilege has been claimed and not waived or otherwise destroyed.<sup>80</sup>

Each of these elements requires additional scrutiny to establish its existence or applicability in a given situation. First, the communications between the client and the attorney are protected in order to allow the client to convey all pertinent facts, including the disclosure of any violation of laws or commission of crimes, and to allow the attorney to provide a thorough legal analysis of such facts.<sup>81</sup> To assert this privilege, however, the client must be communicating with an attorney who, in fact, acts as an attorney.<sup>82</sup> In *United States v. Chevron*,<sup>83</sup> the federal district court ruled that Chevron had to establish the existence of the requisite elements before it could invoke the attorney-client privilege, and, thus, keep certain environmental reports and drilling studies from disclosure.<sup>84</sup>

In *Upjohn Co. v. United States*,<sup>85</sup> the U.S. Supreme Court held that the definition of the term "client" is not limited to senior

80. See *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358 (D. Mass. 1950).

81. The A.B.A. MODEL CODE OF PROFESSIONAL RESPONSIBILITY provides broad coverage of attorney-client privilege over attorney-client communications. It also states that under certain circumstances, for example, when the client intends to commit a crime, the lawyer must disclose such communications. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(c)(3).

82. The attorney-client privilege rests on the principle that an attorney must be "acting as an attorney." See Edmond B. Frost et al., *Environmental Audits and Litigation Risks*, PROCEEDING OF THE TENTH ANNUAL HAZARDOUS MATERIALS AND ENVIRONMENTAL MANAGEMENT CONFERENCE/INTERNATIONAL, 13-27, 17 (1992).

83. No. 88-6681, 1989 WL 121616 (E.D. Pa. Oct. 16, 1989).

84. *Id.*

85. 449 U.S. 383 (1981).

executives. It may include middle- and lower-level employees so long as their communications to the attorney are necessary to undertake an investigation or to render legal advice.<sup>86</sup> Independent agents or contractors, however, are not covered under this definition of client.<sup>87</sup>

Second, the attorney-client privilege may only be claimed if the communications are made solely for obtaining legal advice.<sup>88</sup> This is an extremely important element of the privilege, particularly in a corporate or business environment where there is an incessant flow of information, both oral and written, legal and non-legal.<sup>89</sup> In *Fisher v. United States*,<sup>90</sup> the Supreme Court held that the attorney-client privilege is limited to disclosures which are necessary to obtain "informed legal advice" and which might not have been made absent the privilege.<sup>91</sup> Obviously, non-legal communications, even by an attorney, are not protected.<sup>92</sup> A routine internal investigation by an in-house lawyer functioning as a corporate manager may not, therefore, be protected from discovery.

Third, there must be a need for keeping the communications confidential in order to claim the attorney-client privilege.<sup>93</sup> Any

---

86. *Id.* at 394-95.

87. The attorney-client privilege, however, extends to the communications of an independent agent, such as an environmental consultant or an accountant, if such agent is an agent of the attorney and is directly employed by and reports to the attorney. See 81 AM. JUR. 2D *Witnesses* § 418 (1976).

88. If the attorney renders non-legal advice, such as purely technical or financial advice, this privilege cannot be asserted. Hence, the attorney-client privilege may not be asserted in situations where the primary purpose of the attorney's involvement is not to provide legal service. Moreover, this privilege belongs to the client, and the attorney cannot waive it without the client's permission. *Radiant Burners, Inc. v. American Gas Ass'n*, 320 F.2d 314 (7th Cir.), *cert. denied*, 375 U.S. 929 (1963).

89. In a corporate structure, this is indeed a difficult task, since the corporation communicates through its employees and agents. The *Upjohn* Court held that the privilege extends beyond those employees of a corporation who decide or control corporate activities. 449 U.S. at 394-95. *But see* *Consolidated Coal Co. v. Bucyrus-Erie Co.*, 432 N.E.2d 250 (Ill. 1982).

90. 425 U.S. 391 (1976).

91. *Id.* at 403-04.

92. This is inferred from the formula established in *United States v. United Shoe Machinery Corp.*, 89 F. Supp. 357, 358-59 (D. Mass. 1950).

93. Any advertent disclosure of confidential communications results in a

wide circulation of a document, report, or any other piece of information will undoubtedly undermine such a claim. In *Continental Illinois National Bank & Trust Co. v. Indemnity Insurance Co.*,<sup>94</sup> the district court found that a carbon copy of a letter was outside the protection of the privilege as it was "not primarily directed to an attorney."<sup>95</sup> Accordingly, the presence of an "outside" government official in a meeting would destroy the confidentiality of the communication between an attorney and the client.<sup>96</sup> Lastly, the attorney-client privilege can be deemed waived if one is careless. For example, this privilege is destroyed if the communications between the client and the attorney occur in the presence of third parties or are later disclosed to third parties.<sup>97</sup>

To claim an attorney-client privilege, all communications between the client and the attorney must be scrupulously conducted without any ambiguity regarding their purpose. They should have an appearance of confidentiality and, if written, should carry unmistakable tags such as "privileged and confidential" or "protected by attorney-client privilege." In summary, the privilege can easily be waived, or may result in a waiver, if communications are not handled carefully.

### B. *The Work Product Doctrine*

The work product doctrine, according to Rule 26(b)(3) of the Federal Rules of Civil Procedure, protects documents "prepared in anticipation of litigation or for trial."<sup>98</sup> Thus, this rule establishes only a qualified protection. In *Hickman v. Taylor*,<sup>99</sup> the Supreme Court acknowledged the public policy allowing an attor-

---

waiver of the attorney-client privilege. See CHARLES W. WOLFRAM, *MODERN LEGAL ETHICS* 302 (1986).

94. No. 87C-0439 (N.D. Ill. Oct. 30, 1989).

95. *Id.*

96. *Id.* at 8.

97. This effectively takes away the "confidential" aspect of the communication. See generally THOMAS H. TRUITT ET AL., *ENVIRONMENTAL AUDITING HANDBOOK*, Chapter 3 (2d ed. 1983).

98. FED. R. CIV. P. 26(b)(3).

99. 329 U.S. 495 (1947). This decision, and the work product doctrine, have been codified in Rule 26(b)(3) of the Federal Rules of Civil Procedures.

ney to work with a certain degree of privacy. The Court also noted that if discovery of personal recollections of an attorney were to be permitted, much of what is now written down by an attorney would remain unwritten.<sup>100</sup>

The work product doctrine does not provide as broad a protection as offered by the attorney-client privilege. According to Rule 26(b)(3) of the Federal Rules of Civil Procedure, only qualified protection of an attorney's "mental impressions, conclusions, opinions or legal theories" is available under the work product doctrine.<sup>101</sup> In *United States v. Gulf Oil Corp.*,<sup>102</sup> the court held that the work product doctrine does not apply to documents prepared by the auditors in response to the requirements of federal securities laws.<sup>103</sup>

This doctrine, therefore, does not apply to documents prepared in the regular course of business when there is no litigation being contemplated.<sup>104</sup> The critical factor in asserting the work product doctrine is the imminence of litigation.<sup>105</sup> The courts have generally recognized a substantial probability, a real prospect, or an immediate showing as indicative of imminent litigation.<sup>106</sup>

Lastly, as in the case of the attorney-client privilege, the work product protection can be destroyed by waiver, either through prior disclosure or by failure to maintain confidentiality. Howev-

---

100. *Id.* at 511. See also *Daniels v. Allen Indus., Inc.*, 216 N.W.2d 762 (Mich. 1974).

101. FED. R. CIV. P. 26(b)(3). The underlying facts of such documents are not protected by this rule. See *Frost*, *supra* note 82, at 20.

102. 760 F.2d 292 (Temp. Emer. Ct. App. 1985).

103. *Id.* See also 8 CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2024 nn.24, 25 (Supp. 1988).

104. The work product doctrine can only be asserted when the communication is made and the materials are prepared in anticipation of litigation. *Hickman v. Taylor*, 329 U.S. 495, 511 (1947).

105. Any assertion of litigation must be *bona fide*, which means that the claimant must prove that the prospect of litigation was real and not imaginary. See *Frost*, *supra* note 82, at 19-20.

106. There is no specific criterion for establishing imminence of litigation. Based on the decisions of the courts, however, the burden of proof that litigation is impending rests on the claimant of the doctrine. See *James Julian, Inc. v. Raytheon Co.*, 93 F.R.D. 138 (D. Del. 1982); *Henry Enters. v. Smith*, 592 P.2d 915 (Kan. 1979).

er, like the attorney-client privilege, disclosure to a party with a common interest will not act as a waiver. The essence of this doctrine is to protect evidence from disclosure to opposing counsel and his or her client, but not from the rest of the world.<sup>107</sup>

### C. *The Self-Evaluation Privilege*

The self-evaluation privilege (also known as self-critical analysis) was created by the judiciary to protect certain internal documents from discovery.<sup>108</sup> As in the case of the work product doctrine, this privilege is based on public policy.<sup>109</sup> The underlying public policy is to promote and foster candid and honest self-evaluation.<sup>110</sup>

The application of the self-evaluation privilege to date has been considerably narrow, and many courts have yet to accept the privilege or provide specific parameters for its application — as in the case of the attorney-client privilege. Even those courts which are receptive to this doctrine will look hard to determine whether the information being protected actually emanates from confidential self-analysis and whether its disclosure will promote or harm the public interest. In *Emerson Electric Co. v.*

107. See *Doe v. United States*, 662 F.2d 1073 (4th Cir. 1981), *cert. denied*, 455 U.S. 1000 (1982); *Byrnes v. IDS Realty Trust*, 85 F.R.D. 679 (S.D.N.Y. 1980).

108. The self-evaluation privilege was first recognized in a medical malpractice action. See *Bredice v. Doctors Hosp., Inc.*, 51 F.R.D. 187 (D.D.C. 1970), *aff'd*, 479 F.2d 920 (1973). Since the decision by the *Bredice* court, most jurisdictions have come to recognize and accept this privilege where protection of the peer review process is important. See *Frost*, *supra* note 82, at 21; *Roberts v. National Detroit Corp.*, 87 F.R.D. 30 (E.D. Mich. 1980); *Gilman v. United States*, 53 F.R.D. 316 (S.D.N.Y. 1971).

109. This privilege is strictly embedded in public policy and has not yet found its way into any specific federal or state legislation. Moreover, this privilege does not extend to all legal investigations and enforcement. For example, this privilege does not apply to grand jury proceedings. See *In re Grand Jury Proceedings*, Cir. K-94-2153, 1994 U.S. Dist. LEXIS 11854 (D. Md. Aug. 23, 1994).

110. The policy emerged from a realization of the need to balance broad public access to information and a recognition of the fact that full self-analysis and self-criticism are not practically feasible without some protection against their fall-out. See *Granger v. National R.R. Passenger Corp.*, 116 F.R.D. 507 (E.D. Pa. 1987); *In re LTV Sec. Litig.*, 89 F.R.D. 595 (N.D. Tex. 1981).

*Schlesinger*,<sup>111</sup> the Eighth Circuit Court of Appeals rejected the company's claim of the self-evaluation privilege after determining that the information sought was not prepared for internal use.<sup>112</sup>

In a recent case, however, the District Court for the Northern District of Florida recognized the importance of a self-critical analysis or self-evaluation privilege to allay corporate fears that such would be used as evidence against them.<sup>113</sup> The court held that the documents produced by the company during its investigation of groundwater contamination were protected from discovery under such qualified privilege.<sup>114</sup> The court held that the public interest in environmental compliance is furthered when there is a candid assessment of various legal and regulatory compliance and there is no fear of harm from the prejudicial nature of such evidence.<sup>115</sup> The court defined the scope of this privilege narrowly and laid down the following four criteria for asserting the self evaluation privilege:

- (1)the information must result from a critical self-analysis undertaken by the party seeking protection;
- (2)the public must have a strong interest to preserve the free flow of the type of information sought for protection from discovery;
- (3)the information must be of a type whose free flow would be curtailed if discovery were allowed; and
- (4)the allegedly privileged document must have been prepared with the expectation that it would be kept confidential.<sup>116</sup>

Recent court decisions in several cases imply that the self-evalua-

---

111. 609 F.2d 898 (8th Cir. 1979).

112. *Id.*

113. *Reichhold Chem., Inc. v. Textron Inc.*, 157 F.R.D. 522 (N.D. Fla. 1994). The *Reichhold Chemicals* court cited the decision in *Southern Ry. Co. v. Lanham*, 403 F.2d 119 (5th Cir. 1968), in order to recognize and affirm the self-critical analysis privilege. The court, however, also acknowledged that this privilege had not been universally accepted and that it is a limited privilege. *Reichhold Chem. Co.*, 157 F.R.D. at 527-28.

114. *Id.* at 533.

115. *Id.* at 524. *But see* *Koppers Co. v. Aetna Casualty & Sur. Co.*, 847 F. Supp. 360 (W.D. Pa.), *mandamus granted, order vacated*, 40 F.3d 1240 (3d Cir. 1994) (holding that self-evaluation privilege does not apply to environmental reports, records and memoranda).

116. *See* *Dowling v. American Haw. Cruises, Inc.*, 971 F.2d 423, 426 (9th Cir. 1992); *Reichhold Chem.*, 157 F.R.D. 522.



tion privilege may be asserted only in private litigation.<sup>117</sup> As a result, the application of this privilege against the disclosure request of a governmental entity is doubtful.

The self-evaluation privilege is asserted most often in connection with SEC investigations. Recent securities cases indicate that routine environmental audits conducted for internal monitoring should enjoy protection from private party discovery requests.<sup>118</sup> Even in those situations, however, this privilege is not guaranteed, as it represents the balance between two important but competing interests—importance of public access to relevant information versus the need for confidential self-analysis and self-criticism.<sup>119</sup>

## V. LEGAL OBLIGATIONS FOR DISCLOSURE

Unfortunately, the regulated community has certain disclosure obligations under federal, state, and local laws and regulations.<sup>120</sup> Even the protection afforded by the Fifth Amendment against self-incrimination is limited. It applies only to compelled personal testimony and only in criminal proceedings. In *Kastigar*

117. *FTC v. TRW Inc.*, 628 F.2d 207 (D.C. Cir. 1980). *See United States v. Dexter*, 132 F.R.D. 8 (D. Conn. 1990); *Martin v. Potomac Elec. Power Co.*, No. 88-0106 (D.D.C. May 25, 1990). Some courts have accepted a doctrine of "limited waiver," whereby the court will require disclosure to a government agency without waiving the privilege to a private party. *See, e.g., Diversified Indus. v. Meredith*, 572 F.2d 596, 602 (8th Cir. 1977).

118. *See generally* Ronald J. Allen & Cynthia M. Hazelwood, *Preserving the Confidentiality of Internal Corporate Investigations*, 12 J. CORP. L. 355-381 (1987); *see also* *In re LTV Sec. Litig.*, 89 F.R.D. 595 (N.D. Tex. 1981); *SEC v. Allied Chem. Corp.*, No. 77-0373 (D.D.C. Mar. 4, 1977); *SEC v. United States Steel Corp.*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,319 (Sept. 27, 1979); *New York Stock Exch., Inc. v. Sloan*, 22 Fed. R. Serv. 2d (Callaghan) 500 (S.D.N.Y. 1976). *But see* *Natural Resources Defense Council, Inc. v. SEC*, 606 F.2d 1031 (D.C. Cir. 1979) (holding that SEC may rely on its materiality standard to decide whether environmental policies of corporations must be disclosed).

119. *See Granger v. National R.R. Passenger Corp.*, 116 F.R.D. 507, 508 (E.D. Pa. 1987); Dowden, *supra* note 8, at 174.

120. There are specific "right to know" disclosure reporting obligations or notification requirements under several federal environmental laws. *See, e.g.,* 42 U.S.C. §§ 7401-7671 (1994) (Clean Air Act); 42 U.S.C. §§ 6901-6991 (1994) (RCRA); 42 U.S.C. §§ 9601-9675 (1994) (CERCLA).

*v. United States*,<sup>121</sup> the Supreme Court held that one may be compelled to testify if granted immunity from the use of such testimony in subsequent criminal proceedings.<sup>122</sup> Currently, under the Clean Water Act,<sup>123</sup> knowledge of an actual or suspected spill of a regulated substance, whether caused accidentally or intentionally, can trigger notice and record-keeping requirements as well as containment and cleanup.<sup>124</sup>

Historically, an oil spill or release has received the most congressional attention.<sup>125</sup> Thus, the reporting requirement for an oil spill has been statutorily prescribed in the original Federal Water Pollution Control Act of 1972.<sup>126</sup> At present, the Clean Water Act requires reporting of any non-permitted release of any regulated substance, such as oil or a hazardous substance.<sup>127</sup>

The enactment of several major environmental statutes, such as CERCLA, as amended by SARA, has created additional spill reporting obligations.<sup>128</sup> In fact, several federal environmental statutes and attendant regulations contain specific provisions for reporting spills or releases of oil,<sup>129</sup> hazardous substances,<sup>130</sup> toxic or hazardous chemicals,<sup>131</sup> and other regulated materials

---

121. 406 U.S. 441 (1972).

122. *Id.*

123. 33 U.S.C. §§ 1251-1387 (1994).

124. 40 C.F.R. Part 112 (1995).

125. The need for protection and prevention of oil pollution of receiving water-bodies played a key role in the passage of the Federal Water Pollution Control Act of 1972, 33 U.S.C. §§ 1251-1387 (1994); *see* Non-Transportation Related On-Shore and Offshore Facilities, 38 Fed. Reg. 34,165 (Dec. 11, 1973).

126. 33 U.S.C. §§ 1251-1387 (1994). There are specific reporting requirements in the National Pollutant Discharge Elimination System ("NPDES") permits issued under the Clean Water Act. 33 U.S.C. § 1342(a)(2) (1994).

127. 33 U.S.C. § 1321(b)(5) (1994).

128. There is a mandatory notification requirement concerning the release of hazardous substances. 42 U.S.C. § 9603 (1994).

129. 33 U.S.C. § 1321(b)(5) (1994) (Clean Water Act).

130. 42 U.S.C. §§ 9602-9603 (1994) (CERCLA).

131. Under section 313 of EPCRA, any facility with ten or more full-time employees and falling within SIC Codes 20-34 must file the Form R, an annual toxic chemical release reporting form prepared by EPA, each year if it triggers the threshold amount for usage, manufacturing or processing a listed toxic chemical in the preceding calendar year. 42 U.S.C. § 11023 (1994); 40 C.F.R. Part 372 (1995).

into the environment.<sup>132</sup> These federal statutes are:

- The Federal Water Pollution Control Act ("FWPCA")<sup>133</sup> as amended by the Clean Water Act ("CWA"), along with its latest amendment, the Water Quality Act ("WQA");<sup>134</sup>

- The Occupational Safety and Health Act ("OSHA");<sup>135</sup>

- The Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA");<sup>136</sup>

- The Superfund Amendments and Reauthorization Act ("SARA"),<sup>137</sup> including the Emergency Planning and Community Right-to-Know Act ("EPCRA")<sup>138</sup> as included in Title III of SARA;<sup>139</sup>

- The Toxic Substances Control Act ("TSCA");<sup>140</sup>

- The Hazardous Materials Transportation Act ("HMTA");<sup>141</sup>

- The Resource Conservation and Recovery Act ("RCRA");<sup>142</sup>

- The Clean Air Act ("CAA");<sup>143</sup>

- The Oil Pollution Act ("OPA");<sup>144</sup> and

132. See 42 U.S.C. § 7661(c) (1994) (RCRA). In the common parlance of environmental matters, the word "environment" is often used to indicate air, water, or land, or some combination thereof. Besides protection concerns over the environment, almost all environmental statutes contain some provisions to safeguard public health. Additionally, the Hazard Communication Standard under the Occupational Safety and Health Act, 29 U.S.C. §§ 651-678 (1988), includes four principal disclosure requirements. 29 C.F.R. § 1910.1200 (1995).

133. 33 U.S.C. §§ 1251-1387 (1994).

134. The Clean Water Act of 1977, Pub. L. No. 95-217, is a significant amendment to the Federal Water Pollution Control Act of 1972, 33 U.S.C. §§ 1251-1387 (1994), and contains specific provisions for toxic pollutants. The Water Quality Act of 1987, Pub. L. No. 100-4, is the latest significant amendment to the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251-1387 (1994).

135. 29 U.S.C. §§ 651-678 (1994).

136. 42 U.S.C. §§ 9601-9675 (1994).

137. Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613 (codified as amended in scattered sections of 10, 26, 29, 33, 42 U.S.C. (1994)).

138. 42 U.S.C. §§ 11001-11005 (1994).

139. EPCRA constitutes Title III of SARA and is often referred to as "Sara Title III," codified at 42 U.S.C. §§ 11000-49 (1994).

140. 15 U.S.C. §§ 2601-2692 (1994).

141. 49 U.S.C. §§ 5101, 03, 12, 21 (1994).

142. 42 U.S.C. §§ 6901-6992(k) (1994).

143. 42 U.S.C. §§ 7401-7671q (1994).

144. 33 U.S.C. §§ 2701-2761 (1994).

The Pollution Prevention Act ("PPA").<sup>145</sup>

The reporting or disclosure obligations under these statutes vary. In fact, reporting requirements triggered by a release of a specific substance or chemical are not always covered in the statute that otherwise covers handling or management of such chemicals. For example, spill reportable quantities ("RQs") for polychlorinated biphenyls ("PCBs") and other toxic pollutants are provided under CERCLA<sup>146</sup> and not under TSCA, although TSCA provides specific statutory provisions to handle and manage PCBs.

Also, the reporting or disclosure obligation is not automatically imposed on the same parties. In most cases, the owner or operator of the facility, or the vessel, as the case may be, from which a release occurs is obligated to report.<sup>147</sup> In some cases, however, the reporting obligation shifts to the person in charge.<sup>148</sup> Under OPA, for a spill in a deepwater port, this obligation rests with the licensee.<sup>149</sup> In other situations, for example under the Navigation Law of the State of New York,<sup>150</sup> the person actually causing the spill or the unpermitted release must report such an incident.<sup>151</sup>

Since some of these unregulated, unpermitted releases may result in an explosion or fire and may involve toxic chemicals that can have a serious adverse impact on public health and safety, many state and local laws and regulations include comprehensive and multi-party notification requirements.<sup>152</sup> Such reporting

---

145. 42 U.S.C. §§ 13101-13109 (1994).

146. EPA has established the "reportable quantities" for designated hazardous substances based on its authority granted by CERCLA. Polychlorinated Biphenyl is an EPA-listed hazardous substance under CERCLA. See 40 C.F.R. Part 302.4 (1995).

147. See 42 U.S.C. § 11004(c) (1994). See generally Statement of Interpretation and Enforcement Policy, 43 Fed. Reg. 11,110 (1978).

148. See section 311(b)(5) of the Clean Water Act, 33 U.S.C. § 1321(b)(5) (1994). The "person in charge" implies a supervisory employee. However, CWA does not define this term. The Second Circuit Court of Appeals, in *United States v. Carr*, 880 F.2d 1550 (2d Cir. 1989), held that a low level supervisory employee may be found criminally liable for failure to report a release. See 42 U.S.C. § 9603 (1988).

149. 33 U.S.C. § 2701(32)(D) (1994).

150. N.Y. NAV. LAW § 175 (McKinney 1989).

151. *Id.*

152. Most often, based on state and local laws that are written as a result of

obligations are not preempted or automatically covered by the reporting requirements prescribed by federal statutes and regulations.<sup>153</sup>

The obvious implication of the reporting requirements is simple: the responsible party must disclose certain information within a specific time period after the occurrence of the incident to avoid liability that may arise from a failure to report on time. This requirement cannot be waived or bypassed under the guise of confidentiality or privilege. Therefore, if an unpermitted release is discovered during a voluntary compliance audit, the relevant statutes or regulations may require disclosure to various bodies.

Furthermore, certain public policies require immediate disclosure of known or suspected public hazards. In *Kansas Gas & Electric v. Eye*,<sup>154</sup> a Kansas court, using a balancing test, held that the benefit to society conferred by disclosure of certain safety information was greater than the injury caused to the corporation by disclosure of the same information.<sup>155</sup> While application of such a balancing test is arguably not widespread, one cannot be too confident in enjoining disclosure of otherwise confidential information, particularly when a strong public interest demands disclosure.

---

the passage of EPCRA, notices are to be given to the local police and fire departments. Under EPCRA, the state emergency response commission and the local emergency planning committee must be notified in the event of a release of an extremely hazardous substance in a quantity that exceeds its "reportable quantity." 42 U.S.C. § 11004 (1994).

153. There are specific state disclosure requirements under state statutes. *See, e.g.*, N.Y. ENVTL. CONSERV. LAW § 17-1743 (McKinney 1984); N.J. STAT. ANN. § 13:1K-16 (West 1992); CAL. HEALTH & SAFETY CODE § 25359.7(a) (West 1992); Michigan Environmental Response Act, MICH. COMP. LAWS ANN. § 324.20114 (West Supp. 1995). These reporting requirements are not pre-empted by the federal environmental and safety laws.

154. 789 P.2d 1161 (Kan. 1990).

155. *Id.* at 1168.

## VI. THE QUANDARY AND THE CONFLICT

Based on certain enforcement agenda, the regulatory agencies, and enforcement officials from DOJ, have come to expect full disclosure of the findings of compliance audits even though the audits are voluntary.<sup>156</sup> This expectation is in sharp contrast to the perceived need of the regulated community to keep such findings confidential to avoid self-incrimination. The one-sided positions of EPA and DOJ openly conveyed in EPA's 1986 policy statement covering compliance audits has increased confusion and made the parties distrustful of each other.<sup>157</sup> This position has also dampened the initial interest of the business community in undertaking compliance audits and, thus, achieving better control over their respective environmental matters.

Earlier statements and actions by agency officials did not help in explaining the contents of the 1986 EPA policy statement. For example, on June 26, 1981, Gary Lynch, Assistant Director of Enforcement of the SEC, proclaimed that inadequate environmental disclosures by companies may result in SEC enforcement.<sup>158</sup> Before the dust had settled from this surprise announcement, EPA's 1986 policy<sup>159</sup> openly suggested complete disclosure while attempting to persuade the business community to voluntarily undertake compliance audits.<sup>160</sup> EPA's expectation of full

---

156. DOJ's own policy encourages the use of its authority to request the production of the reports or findings of environmental audits in spite of its stated goal of encouraging "self-auditing, self-policing, and voluntary disclosure of environmental violations." See *DOJ Memorandum*, *supra* note 7, at 3-4.

157. See generally Marianne Lavelle, *EPA: Confess and Pay Less*, NAT'L L.J., Apr. 17, 1995, at A6, A7.

158. Gary Lynch, *Environmental Audits Seen Reducing Problems of Hazardous Wastes*, 12 Env't Rep. (BNA) No. 9 at 288, 289 (June 26, 1981). Both the Securities Act of 1933, 15 USC §§ 77a-77bbb (1994), and the Securities Exchange Act of 1934, 15 USC §§ 78a-78ll (1994), impose disclosure duties of a broad range and type of information, including environmental matters. SEC promulgated Regulation S-K governing these disclosure obligations. See 17 C.F.R. Part 229 (1995); *Natural Resources Defense Council, Inc. v. SEC*, 606 F.2d 1031 (D.C. Cir. 1979). More specifically, the Staff Accounting Bulletin No. 92 ("SAB 92") imposes a substantial burden upon publicly traded companies to disclose environmental liabilities and possible future "exit costs." See generally Publication of Staff Accounting Bulletin No. 92, 58 Fed. Reg. 32,843 (1993).

159. See Final Auditing Statement, *supra* note 3, at 25,004.

160. One can argue that this suggestion is an oxymoron since the suggested

disclosure became, perhaps unwittingly, a Machiavellian ploy when it mentioned prosecutorial discretion for settling past violations as an enticement to such disclosure.<sup>161</sup>

Subsequent legislative enactments at the state level have created further confusion and mistrust. For example, both New Jersey and Connecticut have enacted property transfer laws requiring disclosure and/or cleanup of existing hazardous substances from industrial properties or establishments prior to their closure, transfer or sale.<sup>162</sup> While these statutory requirements are not voluntary, they do not require as broad and sweeping an investigation as that of a typical compliance audit.<sup>163</sup> Nevertheless, they have created the misconception that unless real estate is being leased, transferred, or acquired, a compliance audit does not have any tangible value.<sup>164</sup>

Taken together, the well-touted privilege of undertaking compliance audits by the business community during the late 1970s and early 1980s has now been shrouded by a veil of suspicion and confusion. The unfortunate effect is that any discussion of the

action appears to be contradictory to the old theory of *quid pro quo*.

161. See generally Mary E. Kris & Gail L. Vannellis, *Today's Criminal Enforcement Program: Why You May be Vulnerable and Why You Should Guard Against Prosecution of an Environmental Audit*, 16 COLUM. J. ENVTL. L. 227 (1991).

162. These statutes require disclosure of environmental conditions in terms of waste generation and past industrial activities but do not impose any specific environmental investigation or assessment. See, e.g., Connecticut Transfer of Hazardous Waste Establishment Act, CONN. GEN. STAT. § 22a-134, as amended (1995); New Jersey's Environmental Cleanup Responsibility Act, N.J. STAT. ANN. § 13:1K-13 (West 1991).

163. See New Jersey Environmental Cleanup Responsibility Act, N.J. STAT. ANN. § 13:1K-14 (West 1991).

164. The property transfer laws of Connecticut and New Jersey have generally been triggered when the ownership of an industrial establishment generating hazardous wastes or involving certain hazardous industrial activities is being transferred or otherwise acquired by a new owner. See, e.g., CONN. GEN. STAT. § 22a-134 (1995). There is no statutory or regulatory language requiring anyone, including those industrial establishments, to undertake an environmental compliance audit for ongoing operations. See New Jersey Environmental Responsibility Act, N.J. STAT. § 13:K-6; Michigan Seller Disclosure Act, MICH. CORP. LAWS § 565.951 *et seq.*; ILL. REP. STAT. Ch. 30, ¶ 901; CAL. HEALTH & SAFETY CODE § 25359.7(a).

benefits of a well-conceived compliance audit has a hollow ring. Very few corporations believe that a compliance audit should be a part of the operational or business plan of a corporation to assess its past efforts and to pave the way for future improvement and goals. Gone are the healthy aspirations of the business community to get a better handle on its environmental permitting and compliance matters and to avoid unnecessary, protracted, and expensive litigation stemming from voluntarily disclosed violations.

These aspirations have been replaced by a strong feeling within the business community that undertaking a voluntary compliance audit is maddening. Any demand to disclose the findings of a compliance audit to the regulatory agencies has all the ingredients of self-incrimination, without the protection of the Fifth Amendment. Several state court decisions have added fire to the fury. In *Ohio v. CECOS International, Inc.*,<sup>165</sup> the Ohio Court of Appeals recognized that discovery of environmental audits may have a chilling effect on internal corporate investigations and troubleshooting efforts.<sup>166</sup> Nevertheless, the court held that internally generated performance evaluations are not privileged.<sup>167</sup> Unfortunately, the United States Supreme Court has not yet decided a case involving disclosure requirements of compliance audits.

From a conservative approach, undertaking a voluntary compliance audit should not be pursued unless there is a formal agreement with the pertinent agencies about settling any environmental violation discovered during such an audit. The possibility of such agreement is, of course, extremely remote. This puts any potential benefits that may be derived from undertaking compliance audits in the category of what could have been or should have been.

Unfortunately, congressional attempts to curb environmental crimes and other unscrupulous "knowing" or "unknowing" activities by corporations and their employees have generally failed to send a proper message.<sup>168</sup> Almost all of the recent federal envi-

---

165. 583 N.E.2d 1118 (Ohio Ct. App. 1990).

166. *Id.* at 1119.

167. *Id.* at 1121.

168. The term "knowing" has been included in several federal environmental statutes, including the Clean Water Act, the Clean Air Act and the Resource Con-



ronmental statutes contain ambiguous language, largely as a result of political compromise.<sup>169</sup> This, in turn, has left interpretation and implementation to the regulatory agencies who are equally influenced by political winds. Finally, it has been left to the nation's courts to sift through the legislative history and make a bookish determination of what these statutory provisions require. As a result, the decisions are seldom pragmatic and, more often than not, create additional confusion.

## VII. THE PRICE AND THE PERCEIVED DANGER

Tough talk by agency and enforcement officials against the dangers of maintaining poor or incomplete compliance records by the regulated community has had very little impact regarding the benefit of compliance audits. The current position of EPA and DOJ demanding complete disclosure of compliance audit findings has fallen on deaf ears. Worse, it has resulted in a total lack of interest in voluntary undertakings. While there may be debates about whether or not the stepped-up enforcement program by the agencies will improve overall compliance records, it is generally agreed that the entire voluntary program of compliance audits has

---

servation and Recovery Act. *See* 33 U.S.C. § 1319(c)(2) (1994); 42 U.S.C. § 6928(d) (1994); 42 U.S.C. § 7413(c) (1994). Although the term is not defined, the courts have generally held that in order to prove a knowing activity or knowing conduct, the plaintiff must prove that the defendant acted voluntarily and consciously, and not by mere accident or inadvertence. *See* S. REP. NO. 1172, 96th Cong., 2d Sess. 39 (1980), *reprinted in* 1980 U.S.C.C.A.N. 5019, 5038; *United States v. Greer*, 850 F.2d 1447, 1450 (11th Cir. 1988); *United States v. Dee*, 912 F.2d 741, 745 (4th Cir. 1990), *cert. denied*, 499 U.S. 919 (1991). Unlike the criminal codes, there is no standard based on mental intent or mens rea to prove the defendant's guilt. *See United States v. International Minerals & Chem. Corp.*, 402 U.S. 558 (1971). Any "knowing" violation of environmental laws, or any instance where a responsible corporate manager "should have known," can be a potential criminal violation under several major environmental laws. *See generally* RIDGWAY M. HALL, JR. & DAVID R. CASE, *ALL ABOUT ENVIRONMENTAL AUDITING* 2-5 (2d ed. 1992).

169. The current debate and dilemma started with the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6992, wherein the Congress first introduced the term "knowing" in an environmental statute, but left it to the courts to interpret the exact definition. *See United States v. Hoflin*, 880 F.2d 1033 (9th Cir. 1989).

been a bust. In essence, it is now a source of high-level frustration for both the regulators and the regulated.

On November 14, 1986, in an internal memorandum,<sup>170</sup> Thomas L. Adams, Jr., EPA's Assistant Administrator for Enforcement and Compliance Monitoring, explained EPA's policy on the inclusion of environmental auditing provisions in enforcement settlements.<sup>171</sup> At the same time, he indicated that an environmental audit is an integral part of a settlement of judicial and administrative enforcement cases.<sup>172</sup> He made no mention of EPA's position conveyed in the July 1986 policy statement which reserves a right for EPA "to act at variance"<sup>173</sup> with its stated policies and procedures and "to change them at any time without public notice."<sup>174</sup> This means that even the expected leniency by the enforcement officials during a penalty settlement, based on an open disclosure of a violation unearthed during a compliance audit, may be an illusion.

This double-talk obviously goes to the core of the regulated community's current distrust of agency advocacy. A high level of fear already exists in the corporate world based on the civil and criminal sanctions contained in several major environmental statutes. The fact that these provisions attach personal liability to corporate officers and other responsible employees has only added more distrust.<sup>175</sup> Besides CAAA, several federal environmental statutes contain provisions for both civil penalties and criminal

---

170. ENVIRONMENTAL AUDITS at App. I (Lawrence B. Cahill & Raymond W. Kane eds., 6th ed. 1989).

171. Memorandum from Thomas L. Adams, Jr., *supra* note 35.

172. EPA has often included a comprehensive environmental compliance audit as a distinct condition of its consent order issued to an alleged violator. *See United States v. Menominee Paper Co.*, No. M88-108 CA 2 (W.D. Mich. July 20, 1990). Not surprisingly, this is becoming a common condition in consent orders issued by the state regulatory agencies.

173. *See* Final Auditing Statement, *supra* note 3, at 25,007.

174. *Id.* at 25,006.

175. In *United States v. A&P Trucking Co.*, 358 U.S. 121 (1958), the Supreme Court applied the doctrine of *respondeat superior* to impute the knowing violation of an agent to a corporate principal. In *People v. Matthews*, 7 Cal. App. 4th 1052, 1063 (Ct. App. 1992), the California Court of Appeals commented, *in dicta*, that the highest corporate officers must meet the standard to "discover, prevent, or remedy" environmental violations.

sanctions against corporate officers and employees. For example, under CERCLA, any failure to report the release of a hazardous substance without a permit may result in a fine, imprisonment for not more than three years (or not more than five years for a subsequent conviction), or both.<sup>176</sup> Civil penalties under most of these federal environmental statutes, on the other hand, can be as high as \$25,000 per day of violation, with each day constituting a separate violation.<sup>177</sup> Under CAAA, the latest major federal environmental statute, for "knowing violations" an individual may be punished by up to \$250,000 in fines and up to five years in prison, or both, and a corporation may be subject to a maximum fine of \$500,000.<sup>178</sup> Additionally, under RCRA, subsequent convictions can double the penalties for both individuals and corporations.<sup>179</sup>

The well publicized get-tough approach at the federal, state, and local agency levels will not be productive in the future without a conciliatory regulatory provision, or at least a policy favoring voluntary compliance audits.<sup>180</sup> In spite of initial enthusiasm within the business community, the past record for undertaking voluntary compliance audits, except in real-estate transactions, has been poor at best.<sup>181</sup> It is a sad reminder of how a well-in-

176. 42 U.S.C. § 9603(b), (c), (d)(2) (1994).

177. *See* 33 U.S.C. § 1319(c) (1994).

178. The Clean Air Act provides various categories of knowing violations. *See* 42 U.S.C. § 7413(b), (c) (1994).

179. *See* 42 U.S.C. § 6928 (1994). Under RCRA, a "knowing endangerment" may subject a person to a fine of not more than \$250,000 or imprisonment for not more than 15 years, or both. For a corporation, for a similar offense, the fine may be as high as \$1,000,000. 42 U.S.C. § 6928(d), (e) (1994).

180. Both EPA's and DOJ's recent policies, discussed earlier, indicate that they will retain full discretion to prosecute despite voluntary disclosure of the compliance audit findings. This approach is also generally being followed by various state and local enforcement agencies. At the same time, these agencies, particularly EPA and DOJ, have announced plans for more aggressive criminal prosecutions under federal environmental laws. *See generally Enforcement*, 25 *Env't Rep.* (BNA) No. 48, 2411-12 (Apr. 7, 1995).

181. The traditional common law notion of *caveat emptor* has found its way into many state real property laws. This trend has received an additional boost by the inclusion of the "innocent landowner" defense in CERCLA. 42 U.S.C. § 9601(35)(A), (B), (C) (1994). Hence, in most real estate transactions, the pro-

tended concept can go awry because of poor planning and a high-handed approach by a federal agency. To salvage the well meaning intent behind the introduction of compliance audits and to overcome the current stalemate, there must be a meaningful revision in EPA's policy.

#### VIII. THE PROGNOSIS AND POSSIBLE CURE

For the most part, it is agreed that a compliance audit is generally a good thing and has certain undeniable benefits. EPA and other regulatory agencies believe that regular compliance audits will make corporate management more aware of environmental issues and pitfalls and will allow them to be more pro-active. This will improve the overall compliance records of the business community and, thus, foster a more environmentally friendly business climate.

The business community, too, finds compliance audits an effective management tool and an efficient way to cure any shortcomings or potential violations without excessive penalties and expensive litigation. The current lack of interest by the business community to pursue compliance audits as part of ongoing operational plans has been caused by the open disclosure policy of EPA unmodified by pardon for unknown past or present violations. This has driven a large wedge between the agencies and the business community with respect to voluntary compliance audits.

There are other important issues to consider as well. The current business climate is increasingly global in scope. As a global player, a business can hardly ignore its image or be officially labeled as a "bad actor" in terms of environmental consciousness. These new realities, including an interest by the corporations to be "green", have given rise to a spirit of optimism, that perhaps there is a way out of the current impasse between the regulatory agencies and the business community. Murray Weidenbaum, the Director of the Center for the Study of American Business at Washington University, has suggested that every corporate man-

---

spective buyer prefers to undertake a voluntary environmental investigation, audit or assessment of the property in question. *See* RESTATEMENT (SECOND) OF TORTS § 353(1) (1965); *Farm Bureau Mut. Ins. Co. v. Wood*, 418 N.W.2d 408 (Mich. Ct. App. 1987).

ager should undertake a complete environmental audit of company activities to determine potential problems.<sup>182</sup>

Indeed, much can be said for the obvious benefits of a well planned, comprehensive compliance audit. As the old adage suggests, an ounce of prevention is worth a pound of cure. For a corporation, early detection of an environmental problem can lead to a quick cure. This, in turn, can save money and improve the balance sheet of a corporation. Also, a compliance audit allows a corporation to be a better global citizen, which has value in today's environmentally conscious climate. With consumer preferences for "green" products, industries have to put a premium on TEQM so that their operations are not labeled as anything other than "green".

As discussed earlier, the current hesitation about undertaking a compliance audit has its roots in the lack of official incentives. EPA's confusing 1986 policy<sup>183</sup> and the tough talk of the enforcement officials have all but extinguished the initial enthusiasm. As a result, only negative feelings and cynicism exist within the business community with respect to the benefits of undertaking voluntary compliance audits. From a public policy point of view, if a compliance audit is not mandated, a forced disclosure of its findings should be avoided unless there are genuine knowing violations. Logic dictates that good deeds should bear tangible benefits, not increased burdens.

The apparent anomaly in the current status quo is being addressed, albeit slowly, in political circles. Fortunately, a few courts have taken a refreshing look at the entire dilemma. In a recent case, *Olen Properties Corp. v. Sheldahl Inc.*,<sup>184</sup> a magistrate of the U.S. District Court for the Central District of California held that environmental audit memoranda can be protected even in the absence of threatened litigation if the audit process is properly structured through attorneys.<sup>185</sup> Moreover, on July 22,

---

182. Robert W. Crandall, *Gearing up for Reregulation*, BUS. MONTH, July 1989, at 66, 67. This is a personal opinion of a leading specialist in federal regulations. It does not imply that there is a regulatory provision requiring environmental audits by the companies.

183. See Final Auditing Statement, *supra* note 3.

184. No. CV 91-6446 WDK (C.D. Cal. Apr. 12, 1994).

185. *Id.*

1993, Governor Barbara Roberts of Oregon signed into law landmark legislation which created a qualified "environmental audit privilege."<sup>186</sup> This law allows the regulated community in Oregon to undertake compliance audits and to rectify any existing violations without the fear of being subject to fines or criminal sanctions.<sup>187</sup>

Several states, including Texas, Mississippi and Virginia, have recently passed legislation protecting voluntary audits from being used by state agencies for the purpose of enforcement.<sup>188</sup> A number of states, including California, New Jersey and Massachusetts, are considering similar legislation that will provide confidentiality and immunity to environmental violators, provided they disclose and cure such violations promptly.<sup>189</sup> On May 11, 1994, the Colorado Legislature passed a bill which specifically creates a privilege for environmental audits.<sup>190</sup> On April 22, 1995, Kansas adopted audit confidentiality legislation.<sup>191</sup> Currently, the results of an environmental audit in Kansas are inadmissible in court and immunity from civil and criminal penalties will be granted for voluntarily disclosed violations.<sup>192</sup>

Several other states, including Indiana and Kentucky, have

---

186. OR. REV. STAT. § 468.963 (1993). The new law in Oregon originated from Senate Bill 912 and contains two specific provisos using the carrot and stick approach. First, it creates a qualified audit privilege so that regulated entities can perform environmental audits and undertake necessary measures to correct or prevent environmental violations. Second, it establishes specific state penalties for environmental violations. *See also* 1993 Or. Laws 468.963(5).

187. *See generally* Lindley & Hodson, *supra* note 4, at 1221.

188. *See* Hogue, *supra* note 56, at 882-83.

189. *See generally* Stephanie N. Mehta & Michael Selz, *Small Business Polluters Get a Chance to Come Clean*, WALL ST. J., Aug. 23, 1995, at B2. Not all state bills have been passed, however. For example, Arizona's Governor Fife Symington vetoed S.B. 1290, a bill that would have made the findings of voluntary compliance audits inadmissible in legal actions. ARIZ.S.B. 1290, 42nd Leg., 2d Reg. Sess. (1996).

190. 1994 Colo. Sess. Laws 139. The Colorado bill, S.B. 139, creates an audit privilege and provides immunity from penalties for entities that self-report and self-correct any past violations uncovered during the audit.

191. *See* 1995 Kan. Sess. Laws 76. This new law makes the results of an environmental audit inadmissible in court. It also offers immunity from both civil and criminal penalties for violations voluntarily disclosed to state regulatory agencies.

192. *Id.*

enacted laws that provide a qualified privilege to environmental audits performed voluntarily.<sup>193</sup> Various environmental audit privilege bills are pending in Arizona, Idaho, Illinois, New York, North Carolina, Ohio, Pennsylvania and Rhode Island.<sup>194</sup>

Two pending bills<sup>195</sup> in the U.S. Congress provide additional encouragement to the growing state-level legislative agenda. If either of these federal bills are passed, they would make the confidentiality and immunity provisions of various state statutes an integral part of federal law.

Unfortunately, EPA's position on the state audit privilege law is anything but conciliatory. EPA has steadfastly and consistently opposed the privilege approach.<sup>196</sup> EPA has in fact gone on record by indicating that the audit privilege provided by the state statutes may be challenged by EPA.<sup>197</sup> EPA alleges that the penalty immunity provisions of these statutes allow the violators to retain the economic benefit derived from past non-compliance.<sup>198</sup>

---

193. See 1994 Ind. Acts 16 (effective July 1, 1994); 1994 Ky. Acts 430 (effective Apr. 11, 1994).

194. See generally Michael K. Ohm et al., *RCRA Criminal Liability: Acts, Consequences and Prevention*, 30 CHEM. WASTE LIT. REP. No. 2, at 230, 260 (July 1995).

195. H.R. 1047, 104th Cong., 1st Sess. (1995) (drafted by Rep. Joel Hefley of Colorado) and S.2371, 103d Cong., 2d Sess. (1994) (introduced by Sen. Mark Hatfield of Oregon).

196. See generally *News and Development, EPA Issues Interim Audit Policy As More States Adopt Audit Privilege Laws*, 4 Env'tl. Due Diligence Guide (BNA) No. 4, at 1 (Apr. 1995).

197. Ira R. Feldman, Special Counsel for EPA's Office of Compliance and Chairman of EPA's Auditing Policy Group, told the Bureau of National Affairs that EPA is neither bound by state audit privilege laws nor precluded from enforcing violations of federal laws. *State Environmental Audit Privilege Laws, Effects on Enforcement Undergoing EPA Review*, 25 Env't Rep. (BNA) No. 11, 495 (July 15, 1994). This warning has also come from DOJ. See *News and Development, EPA to Gather More Data on Audit Policy; DOJ May Challenge New State Audit Laws*, 3 Env'tl. Due Diligence Guide (BNA) No. 9, at 69 (Sept. 1994)[hereinafter *News and Development*].

198. This is the cornerstone of EPA's opposition to immunity for past violations. EPA argues that such violators, if allowed to go unpunished, will be deriving economic benefits over their competitors who complied with relevant environmental laws.

However, EPA's position is not cast in stone. EPA's latest audit policy statement, issued as an interim policy on April 3, 1995, indicates certain changes from its 1986 policy on environmental audits.<sup>199</sup> The interim policy is purely incentive-based. Corporations will be able to completely bypass gravity-based or punitive penalties if they voluntarily identify, disclose and correct violations.<sup>200</sup>

In order to be eligible, a corporation must act in good faith and satisfy seven specific criteria<sup>201</sup> emphasizing self-correction and voluntary disclosure of its violation.<sup>202</sup> Moreover, EPA will not refer criminal violations to DOJ if the corporation satisfies three additional conditions.<sup>203</sup>

---

199. EPA's interim policy statement of April 3, 1995 supersedes its July 1986 policy and clearly indicates, for the first time, that EPA will not seek out voluntary environmental audit findings to trigger enforcement investigations. EPA, however, still opposes federal legislation to avoid penalties for environmental violations uncovered during voluntary audits. *See Interim Policy, supra* note 7.

200. *See Interim Policy, supra* note 7.

201. EPA's Interim Policy does not offer any protection to individuals. The seven mitigating criteria for a corporation are discussed later. *See infra* note 203 and accompanying text.

202. Self-policing, self-correction and prompt disclosure constitute the basic ingredients of the seven principles propounded in EPA's Interim Policy. *Interim Policy, supra* note 7 at 16,876.

203. EPA's Interim Policy of April 3, 1995 identifies the following seven criteria which must be met by an entity in order to have its civil penalty reduced:

- (1) discovery of the violation through a voluntary environmental audit;
- (2) disclosure of the violation fully, voluntarily and in writing to appropriate agency officials immediately upon its discovery and before an agency inspection or notice of a citizen suit or a complaint is filed;
- (3) correction of the violation within 60 days of its discovery, or as soon as possible if additional time is required;
- (4) expeditious remediation of any condition that has created or may create an imminent and substantial endangerment to human health or the environment;
- (5) implementation of appropriate measures to correct environmental harm caused, and prevention of its recurrences;
- (6) demonstration that appropriate steps have been taken to avoid repeat violations; and
- (7) cooperation with EPA, and offer of information as necessary and required by EPA to determine applicability of its policy.

*Id.* The Department of Justice, not being a party to EPA's interim policy, acts



There are, however, no mitigation provisions in the interim policy for situations where "serious actual harm" occurs. In cases that present a substantial risk of a serious harm, but no actual occurrence of a serious harm, corporations will be eligible for a 75 percent gravity-based penalty reduction.<sup>204</sup>

EPA's new interim policy does not provide the full extent of relief that corporations seek from voluntary compliance audits and correcting past violations promptly. Nor does it contain the provisions that various state statutes currently provide. EPA's proposal based on its "seven plus three" conditions<sup>205</sup> emphasizing self correction, voluntary disclosure and management complicity may not satisfy those who seek full immunity based on uncovering, correcting and disclosing past violations voluntarily. The new interim policy, however, is a significant movement from EPA's original position and provides new incentives for disclosure and prompt correction of violations discovered during audits.

It is important to note that as part of its new policy, EPA will not request voluntary environmental audits for the purpose of initiating civil or criminal enforcement actions against an alleged

---

on violations referred to it by EPA. Pursuant to its interim policy, EPA will not refer actions to DOJ if the entity demonstrates that its violation did not include the following three practices:

- (1) a prevalent corporate management philosophy or practice of concealment or condonement of environmental violations;
- (2) any conscious involvement in or willful blindness to the violation by high-level corporate officials or managers; and
- (3) any serious actual harm to human health or the environment.

*Id.* at 16,878.

Notwithstanding, EPA has opposed legislation that could establish any privilege or immunity for past violations voluntarily disclosed. *See News and Development, supra* note 197, at 69. Instead, it has stressed prosecutorial discretion, thus suggesting leniency over such violations, but not complete immunity. *See generally*, Paul J. Curran & Gregory J. Wallace, *Environmental Law*, NAT'L L.J., July 31, 1995, at B4.

204. This is an exception rather than the rule. EPA may mitigate up to 75 percent of the unadjusted gravity component of the penalty in cases where most, but not necessarily all of the seven specific criteria are met. *See Interim Policy, supra* note 7, at 16,877.

205. *Id.*

violator.<sup>206</sup> Moreover, EPA emphasizes that its interim policy will not limit the right of regulated entities to claim common law evidentiary privileges, such as the attorney-client privilege and the work product privilege. However, the interim policy does not rule out the use of information received from voluntary disclosure of audit findings and reports for the purpose of either civil or criminal proceedings.<sup>207</sup>

Even where an uncertainty may exist regarding forced disclosure of the findings of a compliance audit, the constitutional protection against self-incrimination does provide some legal defense. Although the protection is limited in scope and protects only an individual, and not a corporation, against a criminal prosecution, it may be a strong argument against the agencies' arbitrary and capricious policies.

Judge William Wilkins, Jr. of the Court of Appeals for the Fourth Circuit and a member of the U.S. Sentencing Commission, indicated that the November 1993 sentencing guidelines incorporate the theory that the penalties for an offending corporation should be reduced if it voluntarily discloses violations.<sup>208</sup> According to Judge Wilkins, the Commission believes that probation should also be accorded to such a corporation if it cooperates with authorities and sets up a vigorous compliance program.<sup>209</sup>

Above all, the good news is that EPA has yet to drop the final curtain on its enforcement policy on voluntary compliance audits.

---

206. *Id.* at 16,878.

207. *Id.* at 16,879. EPA has repeatedly indicated that any application of its interim policy is purely discretionary and that EPA may change its policy at any time without public notice. See Final Auditing Statement, *supra* note 3, at 25,007.

208. The Commission was created by the Sentencing Reform Act of 1984, Pub. L. 98-473, 98 Stat. 1987, codified as amended at 28 U.S.C. § 994 (1994). The Sentencing Guidelines for all crimes were issued in November 1987. The Organizational Sentencing Guidelines of the Commission, originally issued in 1991, provide for a reduced sentence of a convicted organization if it has implemented an effective program to prevent and detect violations and reports such violations to, and cooperates with, the enforcement agencies. This provision has not been amended in the draft Sentencing Guidelines issued by the United States Sentencing Commission in November 1993. See *New Draft on Sentencing Corporations for Environmental Crimes Released for Review*, *supra* note 31, at 1331.

209. See *Lines Drawn at Hearing on Self-Audits; Industry Representatives Favor Privilege*, 25 Env't Rep. (BNA) No. 13, at 587 (July 29, 1994).

In fact, EPA has gone on record that it is still evaluating its own policy and is willing to reconsider its current strategy of disclosure. On May 13, 1994, Steven Herman, Assistant EPA Administrator for Enforcement and Compliance Assurance, issued a memorandum<sup>210</sup> disclosing EPA's plan to reassess its policy regarding environmental compliance audits.<sup>211</sup> Since then, there have been numerous official and unofficial overtures by EPA officials indicating EPA's strong encouragement for environmentally sound business practices, including performance of compliance audits.<sup>212</sup> It can only be hoped that the U.S. Congress and perhaps the U.S. Supreme Court will appreciate the present anomaly and will, once and for all, put the current controversy regarding compliance audits to rest by providing a clear message. Meanwhile, it is extremely important that EPA and DOJ, two staunch advocates for disclosure of voluntary environmental audit findings, resolve the profound question whether a privilege should be recognized when it promotes sufficiently important interests to outweigh the need for probative evidence.<sup>213</sup>

#### CONCLUSION

Until both the judiciary and the agencies clarify the contours of protection afforded voluntary compliance audits, a prudent corporation may undertake a voluntary compliance audit by making

---

210. Steven Herman, *Agency Policy on Environmental Audits Undergoing Reassessment*, *Offical Says*, 25 Env't Rep. (BNA) No. 5, at 231 (June 3, 1994).

211. The memorandum suggests EPA's willingness to hear a wide range of views on environmental audits. It also implies that EPA's enforcement policies based on audit findings are not rigid.

212. See Open Mike Session on Environmental Auditing; Announcement of Environmental Auditing Policy Docket, 60 Fed. Reg. 3639 (1995). EPA conducted an "open mike" session on January 20, 1995, to provide an opportunity for public comments on whether additional incentives are needed to encourage self-disclosure and correction of environmental violations discovered during environmental audits. This type of session is a clear indication of EPA's willingness to reassess its policy with respect to the environmental audits and to seek more cooperation from the industry. See Steven Herman, EPA Assistant Administrator for Enforcement and Compliance Assurance, in *News and Developments, EPA to Gather More Data on Audit Policy; DOJ May Challenge New State Audit Laws*, 3 Env'tl. Due Diligence Guide (BNA) No. 9, 69 (Sept. 1994).

213. *Trammel v. United States*, 445 U.S. 40, 51 (1980).

sure that the findings of the audit can be protected under the doctrines of privilege discussed earlier. Obviously, such audits should be directed by attorneys with the proper participation of technical consultants and other experts. This may lend credence to a casual observation by the late William McGowan, past Chairman and founder of MCI Corporation, indicating that the best investment he ever made was in lawyers.<sup>214</sup> Hence, although there is no guaranteed safe harbor in environmental compliance auditing, one may have the solace of some legal protection over the findings of such an audit if it is planned and executed correctly.

---

214. See Crandall, *supra* note 182, at 68.

